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General Business Conditions

THE developments in the business situation during January have added some elements of uncertainty to the outlook, but on the whole seem to call for no great revision of previous opinions as to the 1936 prospect, and there is no evidence of change in the prevailing hopefulness. Commodity prices with few exceptions have been firm, including the farm products which in the long run might be affected if the Supreme Court decision invalidating the A.A.A. should lead to increased production. Stock and bond prices likewise have shown strength, with the exception of a brief softening in Government bonds upon the budget and foreign exchange developments described subsequently.

Merchandise markets affected by the ending of the processing taxes, and by uncertainty as to new taxes, have been thrown into temporary disorder. However, the confusion will doubtless be overcome and a basis found for doing business in a normal volume. Otherwise the Spring wholesale buying has developed satisfactorily, with good results reported in furniture and apparel lines among others. Retail merchants generally are budgeting for an increase of 5 to 10 per cent in their sales of Spring goods, as compared with last year, and the gain in New York City for the first half of January was 10.7 per cent. This good business follows a Christmas trade which ended better than it began, with the result that department store sales in December, as reported to the Federal Reserve Board, were up 6 per cent over 193[illegible] to a new high since 1931; chain stores were up 7 per cent, and mail order houses 19.

For reasons noted hereafter, the A.A.A. decision has not been interpreted as threatening a reduction of farm buying power, and the implement companies, the automobile manufacturers, and retailers in the farm States take the view that conditions will be much the same as they had previously expected.

Next to the A.A.A. decision the important event of the month was the passage of the veterans' bonus over the President's veto. Overlooking for the present the increase in the debt, the temporarily stimulating effect which the bonus payments will have is not to be denied. Merchants know from experience with other distributions of Government funds that the recipients will spend them for automobiles, clothing, furnishings, and the other things they need, as well as for the discharge of past obligations. To be sure, the bonds issued to the veterans will be dated June 15 and cannot be cashed before that time. However, the certainty that the funds are coming in will induce spending in anticipation.

Industrial Operations Slightly Lower

Industrial operations during the month have shown a moderate slackening, such as many observers had expected after the unseasonally high level reached during December. The Federal Reserve Board's index of industrial production for that month stood at 103 per cent of the 1923-25 average, which is the highest figure since the Spring of 1930. Moreover, this figure represents an advance of 20 per cent from the low point of last Summer, without interruption. After a rise of this extent a pause is naturally in order, and the bad weather experienced over a large part of the country has been an unfavorable factor. Even with the slackening, industrial operations have continued better than January a year ago, which was the best month up to that time since the Summer of 1933.

Automobile assemblies have been reduced somewhat, and the total for the month will evidently fall below the 421,000 reported for December. It was not expected that January sales would come up to the November and December levels, but the falling off has been moderate, considering the season, and retail deliveries have been running perhaps 30 per cent greater than a year ago, at least until the stormy weather interfered. The general ex-

pectation in Detroit is that sales in February will be about the same as in January, and thereafter will expand seasonally. Production will run ahead of sales until about April 1st, when dealers will be sufficiently stocked for the Spring season. The used car situation is a subject of much comment, but evidently has aroused less concern within the industry than elsewhere. Used car deliveries are showing a greater gain than new car sales, and it is the view that dealers' stocks are not materially out of line with the increased business.

Reduced purchases by the automobile companies are largely responsible for the slackening in steel mill operations, which have run about 10 per cent below December. Steel manufacturers, however, are encouraged by larger orders for railroad steel, which as yet are not reflected in mill activity.

Building contract awards have continued to make a good showing. During the first three weeks of January they were 96 per cent greater than a year ago, and although they declined more than seasonally from December, this was expected in view of the abnormally large volume of public works awards in that month.

Cotton mill operations have slackened a little, reflecting the interruption in the flow of new orders, due to the confusion over the processing tax decisions. Woolen mills, however, continue the high rate of operations which has been a striking feature of business over the past year and a half; they still have good unfilled orders, and the raw wool markets have strengthened further.

Money and Banking

Two notable developments took place in the money market during the month. One was the action of the Federal Reserve Board in raising the minimum margin requirements for brokers' loans, and the other was the action of the Treasury in shifting a portion of its balances from the commercial banks to the Federal Reserve Banks, thus tending to hold down the rise of excess reserves.

Both of these actions are of interest because their effect, whether by design or otherwise, tends to place checks upon the expansion of credit. The action taken with respect to brokers' loans clearly has this purpose in view, and marks the first move by the authorities, since the rising tide of business and speculation began, to invoke the use of the new credit control mechanism.

The New Margin Requirements

The authority to regulate brokers' loans was conferred on the Federal Reserve Board by the Securities Exchange Act of 1934, and under these terms the Board announced its first margin regulations in October, 1934. According to these regulations, brokers were permitted to lend a customer up to (a) 55 per cent of the market value of the security offered, or (b) 100 per cent of the lowest price at which the security sold during the preceding thirty-six months, but not more than 75 per cent of the current market value. (Until July 1, 1936, the low since July 1, 1933, will be considered the low for purposes of the Act.)

Under the new regulations promulgated during the past month, the maximum loan value of securities, calculated upon market quotations, was reduced from 55 to 45 per cent, which is equivalent to raising margin requirements.

The action by the Reserve Board in raising margin requirements follows a period of some weeks during which brokers' loans have shown the first tendency to advance since the current rise in the stock market began last March. During that month a representative index of stock prices averaged 67, while the average of brokers' loans reported by the weekly reporting member banks stood at $993,000,000. By October the average of stock prices had advanced to 95, or by 42 per cent, while the average of brokers' loans declined to $959,000,000. It will be recalled that it was this failure of loans to advance along with the rising stock market that was made the basis of the Reserve Board's refusal last Fall to take action to reduce member bank excess reserves, notwithstanding the recommendation by the Federal Advisory Council and others that excess reserves were too high and ought to be lowered.

Since October, however, the situation has changed somewhat, and from the low point of that month to January 22, brokers' loans, as reported in the weekly bank totals, have increased approximately $170,000,000, or 18 per cent. To be sure, the volume of brokers' loans is still far below what it was at the high point of the boom era; in fact, it is less even than it was at one time in the Summer of 1934. However, considering all the facts of the present situation, the Reserve Board doubtless judged it desirable to make a warning gesture, in which most thoughtful people probably will concur. There is no doubt that inflation psychology has been a large factor in the rise of the stock market over the past year even though much of the buying has been for "cash"; hence if the authorities are expecting to hold inflation in check it is wise to drop a timely hint to that effect at as early a date as possible. Moreover, it should not be supposed that because the stock market has advanced without a correspondingly rapid increase of brokers' loans it necessarily follows that credit operations have played an unimportant part in the rise. The borrowing and spending by the Government has been responsible in large part for the great rise of bank deposits over the past two years, and these deposits have been used for the purchase of stocks as well as for

other things. To the extent that this is so credit has been just as much a factor in the stock market rise as though brokers' loans had undergone a great expansion. The only difference is that the credit is being put out in another form.

Treasury Balances and Excess Reserves

What motives have led the Treasury to alter its practice of carrying all but a fraction of its cash balances with the commercial banks can only be surmised. In December the collection of income taxes, together with cash payments for new Treasury issues sold on the 15th, resulted in the transfer of over half a billion dollars from the commercial banks to the Federal Reserve Banks acting as fiscal agents of the Treasury, thereby reducing the excess reserves of the commercial banks by an equivalent amount. Ordinarily funds collected by the Treasury are paid back into the market within a few days in connection with the ordinary running expenses of the Government, thus rendering any reduction of reserves of temporary duration. In the present instance, however, the Treasury has been following a different procedure, leaving its balances at the Reserve Banks approximately intact around half a billion dollars, and drawing whatever further funds are needed for current expenditures from balances in the commercial banks. The result of this policy has been that excess reserves have been held below previous peaks, notwithstanding the heavy redeposit of currency in the banks following the Christmas trade, and some further inflow of gold from abroad. It would appear that the monetary authorities feel that excess reserves are high enough and they are adopting this procedure as a convenient method of holding them down.

In view of the quantity of inflationary fuel lying about in the form of idle bank deposits and excess reserves, it cannot be said that the Reserve officials and the Treasury have acted precipitately in these preliminary movements looking towards a firmer control over credit. Such moves are favorable omens as far as they go; they are significant, however, only as beginnings. With more than $3,000,000,000 of excess reserves outstanding, the major task of credit control lies ahead. Moreover, while it is all very well and commendable that efforts be made to control credit through regulation of stock market margins and of excess reserves, it should be borne in mind that the key to credit control lies with the budget. So long as the budget is unbalanced, the threat of inflation is ever-present, not only because spending by the Government in excess of revenue itself involves the manufacture of purchasing power through credit operations to cover the deficit, but because large Governmental borrowings require the maintenance of cheap money at all costs.

The Money Market

Except for an advance from ¼ to ½ of 1 per cent in the rate on call loans secured by bankers' bills and Government securities, money rates showed no change during the month. The volume of surplus bank reserves increased, owing to a post-holiday return of $300,000,000 of currency from circulation and gold imports amounting to $40,000,000, but failed to reach the December peak of $3,300,000,000 for reasons described above. On January 29 total excess reserves of all member banks were $3,090,000,000.

Government bonds displayed considerable irregularity during January, being affected by passage of the soldiers' bonus, agitation by the inflation bloc in Congress, and rumors of all kinds affecting the value of the dollar. Prices, however, showed little net change for the month. High grade corporate and municipal bonds were generally firm, while second grade and speculative bonds moved vigorously upward. A feature of the bond market was the continuance of the heavy flow of new issues, chiefly for refunding purposes, at prices and yields unparalleled in some instances in several decades.

In the foreign exchange market, weakness of the dollar was traceable to the same influences responsible for nervousness in Government bonds. With sterling above $5.00 and the franc at 6.68c, consideration is being given to the possibility of a reversal of the gold flow and of some loss of metal by the United States. Silver continued its decline during January, prices reaching a new low for the movement at 19 pence in the London market, equivalent to 42 cents in United States currency. At this level, the world price of silver is lower than it was at the time the United States price raising program was initiated.

Prospects for the Building and Equipment Industries

One of the most encouraging developments of the year just passed has been the spread of improvement into the building and equipment industries. This is the area in which the depression has been felt most acutely, these expenditures being of the kind most readily deferred in times of reduced national income.

Because of the importance of the heavy industries to business recovery, it is of interest to survey the prospects in these lines for the coming year. Happily, the results of such a survey are favorable. While no boom, or anything resembling a boom, seems likely, it appears probable that these industries will continue the gains commenced last year.

Impetus to further revival in these lines springs from a variety of influences. First of all, sentiment is better, due to a growing

conviction that business recovery is making headway, despite handicaps. With profits rising, business men are in a frame of mind to spend more money, not only for replacement of worn-out and obsolete equipment, but in order to prepare for the increased business that they see ahead.

Moreover, the average man, relieved in a measure from the fear of losing his job or of further wage or salary cuts, is also spending more freely. Some of this money is going into home building and the kindred lines that are involved in furnishing a home. The gradual unfreezing of the mortgage market and reduction in mortgage rates of interest are proving helpful to this development.

Still another by-product of the cheap money program that has proved helpful to business has been the opening of the bond market for refunding issues. This is making possible the conversion of much high interest bearing corporate debt, with consequent reduction in the burden of fixed charges. Also, the ability to refund is rendering it unnecessary for corporate treasurers to hoard cash against approaching maturities, thus releasing current funds for current expenditures.

Existing Plant Inadequate

Probably the chief reason for the improved outlook in the capital goods industries lies in the simple fact that the existing plant and equipment are no longer adequate. This statement may seem surprising to some in view of the acknowledged existence of much idle plant capacity in some lines, and of the claim oft-repeated in recent years that business everywhere was over-developed and over-built. Assertions such as the last were always subject to discount, as illustrative of the kind of talk invariably prevalent during periods of discouragement. Idle plant capacity is neither distributed evenly among the industries, nor does it all represent modern and up-to-date equipment. Industry nowadays constantly is finding newer and better ways of doing things, and the scrapping and replacement of obsolete buildings and machinery with more efficient facilities is quite as important a part of the business of the country as the provision of added plant and equipment. Moreover, the physical needs of the country are growing continuously, so that excess capacity, even when temporarily existent, tends to be rapidly eliminated.

Of course, hopes for revival in the heavy industries should not be pitched too high. Despite substantial improvement in business, business men still have plenty to worry about. The unemployment situation continues a retarding influence, particularly in the field of home building. Politics, and the mounting Federal debt, with its promise either of inflation or of heavier taxation, likewise take toll of business confidence. Were it not for these uncertainties there is little reason to doubt that the investment of new capital in industry would be proceeding more rapidly than is now the case.

Outlook for Utility Expenditures

Among the larger users of heavy equipment whose requirements are expected to increase this year over last are the electric light and power companies. At the present time, these companies are operating under a cloud, due to hostile legislation and competition by the Federal Government. Nevertheless, despite these adverse circumstances, which might be expected to put a damper on all new construction, utility budgets for expansion and development during the coming year are reported by the Electrical World at $370,000,000, against $237,000,000 last year, and $170,000,000 during the low year, 1934.

It is true that the expenditures budgeted for this year are much smaller than those of the big years 1924 to 1930 inclusive. During those years they averaged around $804,000,000 annually, reaching a peak in excess of $900,000,000 in 1930 under stimulus of Government urging to business to spend money in the effort to ward off the depression. The significant thing, however, is that there should be any increase at all in the face of existing uncertainties. The reason why the utilities are going ahead is that the consumption of electric current has been increasing rapidly, and is now running at a rate higher even than at the previous peak in 1929—a fact which is commencing to find reflection in earnings despite general reductions in rates in recent years. This increase in consumption is due partly to a substantial recovery in industrial power sales as general manufacturing activity has picked up, but more largely to the steady growth in the number of customers, expanding use of electrical appliances in the homes, and extension of service into rural areas. During recent years the sale of new load building equipment has been widespread. In an address delivered last year, an officer of the General Electric Company estimated that, on the basis of their own sales, the central-station connected load had been increased 25 per cent within five years, because of the sale of load builders over and above those for replacement purposes.

The amount of new utility construction, of course, will be nothing like as great as it would be were the companies not held down to bare necessities by their anxieties over the political situation. Ordinarily, the utilities tend to build ahead of the load, and, aside from the political, many factors would indicate this to be good policy at the present time. Interest

rates are low, construction costs in the future are more likely to advance than to decline, and the use of power is steadily increasing. The political outlook being what it is, however, normal anticipatory building appears to be precluded, but some increased building must be done to take care of pressing needs.

The Situation as to Railway Equipment

The railroads constitute another group of users of heavy equipment whose needs promise to increase this year. During recent years of low traffic and earnings they have bought very little, owing to desire to conserve financial resources. In the five years 1931-35 annual average capital expenditures amounted to only $214,000,000, as against $812,000,000 in the five years 1926-30, a drop of 74 per cent, while the average annual maintenance outlay fell from $2,005,000,000 to $1,062,000,000 or 47 per cent, during the same period.

As a result of these drastically reduced budgets, the railroads have built up a large deferred demand for rolling stock and other equipment. Since 1929, the percentage of locomotives in need of repair has risen from 16.3 to 22.2, and the percentage of bad order freight cars from 6.0 to 15.0. At least 60 per cent of all steam locomotives owned by Class I railroads are more than 20 years old, while only 10 per cent can be classed as modern, having been built within the past decade. The average age of some 60 per cent of all freight cars is upwards of 15 years, and a sizeable part of the existing freight equipment also is considered obsolete.

So long as traffic was low, the high percentage of bad order and obsolete cars and locomotives was not a serious matter, as it simply meant laying up the poorest equipment. Now, however, that traffic is increasing, the need for new and up-to-date equipment has become more pressing. At the peak of traffic last Fall the surplus of freight cars classed as "serviceable" was down to 208,000, against an average of 230,000 through 1929, and a peak average of 700,000 for 1932. Stored "serviceable" locomotives on October 31, last, were only 3,030, and for the year averaged the lowest in more than ten years. When allowance is made for the fact that equipment reported as "serviceable" cannot always be depended upon to be fit for use, also for the fact that surplus equipment is not evenly distributed as between the different railroads and types of rolling stock, it becomes apparent that the possibilities of shortages developing in some quarters are by no means remote. It is significant that previous years during which car and locomotive surpluses averaged under 300,000 and 6,000, respectively, were years of substantial equipment buying. Already complaints have been made of shortages of open-top coal cars in certain areas, and the Interstate Commerce Commission has called attention to the dangers involved in postponing new equipment purchases for too long a period.

It is conceded that fiscal problems, including pension legislation, the rising burden of taxation, and other uncertainties will tend to retard railway buying. Earnings, however, are showing an increase, and in any case the needs of increasing traffic must be met in one way or another. While no records for expenditure are likely to be broken, it is believed that orders for freight cars may run as high as 50,000 to 60,000, and for locomotives to 300. which would represent a considerable increase over the totals for last year which were approximately 21,230 and 44, respectively. Rail orders in prospect are said to be the largest since 1931, and doubtless other types of equipment and supplies also will be wanted in larger quantities. All this means increased support for the heavy industries, including steel, where already orders for rails and material for freight cars have helped sustain mill operations at a time of lessened buying by the automobile industry.

Revival of Home Building

Outlook for a further gain in residential building is generally agreed to be favorable. In home building, as in the case of expenditures for equipment by the utilities and the railroads, the basis for optimism lies in the long inactivity caused by the depression, during which time the needs of the people for building as well as other things have been accumulating. In this Letter, two months ago, we quoted government figures showing that in 257 cities the number of families provided with new housing dropped from an average of 362,000 during 1921-30 to an average of only 43,000 in 1930-34, and was less than 25,000 in 1932, 1933 and 1934. Meantime, there have been fire losses, condemnations and obsolescence, to say nothing of marriages and population increases.

Beginning last Spring, home building took a turn for the better, and for the year in 37 States amounted to $479,000,000 compared with $249,000,000 in 1934, an increase of 92 per cent. Of this amount, $60,000,000 represented modernizations and other alterations; 92 per cent of the total was financed with private capital as against 8 per cent with public funds. This performance of the building industry last year has aroused optimistic expectations regarding 1936, some predicted increases running as high as 100 per cent.

Undoubtedly, conditions in building and real estate have shown great improvement. Foreclosures have fallen off, vacancy ratios are diminishing, rents are showing a tendency to rise and mortgage money is easier. In addition, general business recovery is making peo-

ple feel better and more willing to undertake the expense of building a home. While building this year may not measure up to the most sanguine predictions, a substantial increase seems assured. This would help business in many lines, though its effects should not be over-estimated; were building to double again this year the total still would be only 37 per cent of the 1924-28 average.

The A.A.A. Decision

Momentous as it is, the decision of the Supreme Court in the Hoosac Mills case, invalidating the processing tax and crop control provisions of the Agricultural Adjustment Act, has had no great effect on prices of farm products. For this there are two chief reasons. First, the emergency for which the A.A.A. was devised is largely past; the burdensome surplus of basic farm commodities (except cotton) has been consumed, and the supplies on the market are in general the smallest in ten years or more. In some commodities, specifically hogs and wheat of milling quality, there is a shortage, and increased production is needed. Thus farm markets are better able to stand alone than in many years. Even if all restrictions on production were removed there could be no oversupply until the next harvest at the earliest, and not even then in most products.

Second, it was recognized almost as soon as the decision was handed down that a substitute for the A.A.A. would be proposed in Congress. This expectation has been realized by the introduction of amendments to the Soil Conservation Act of 1935. The final form of the legislation is uncertain, but the intent is to give the Secretary of Agriculture powers, described as for the promotion of soil conservation, permitting a considerable control of the acreage planted to crops.

For both reasons fears that the decision would lead to a depressing fall of farm prices and income have not been generally accepted. To be sure, doubt as to the constitutionality or practicability of the proposed substitute Act is expressed even by its supporters, who fear it may have a short life if adopted. However, the broader reasons for rejecting the pessimistic view remain. Estimates of a probable increase of farm income in 1936 are not being affected by the decision. Where production is larger, prices may be moderately lower, but the farmers will have more to sell, and they will not be selling in competition with surpluses from past crops. Everyone who handles or processes farm products will have more business. Also, there is another factor in prices besides supply, namely, the probable improvement in demand. The "outlook statement" issued annually by the Department of Agriculture predicts for 1936 a larger demand for farm products in both the United States and foreign countries, due to greater consumer buying power. These conditions in the markets indicate that if the Supreme Court decision requires a return to the principle of an independent agriculture, the time could not be better chosen.

Moreover, a pessimistic view as to the consequences of the decision would imply that continuation of the A.A.A. would benefit the country, and that is a proposition from which many will dissent. It is certain that a stage had been reached where a substantial revision of the agricultural program was desirable, and the policies followed under the Act were expected to be modified in important ways, even without the Court's intervention. It was an experimental Act, described by President Roosevelt as a "new and untrod path," with a promise that if "it does not produce the hoped-for result I shall be the first to acknowledge it and advise you." It was designed as an emergency effort to raise farm prices quickly, in the face of huge surpluses, by restricting production, and as a temporary measure has had approval and support. However, its effectiveness even in the emergency has been questioned by many competent critics, who consider that the drouth has been overwhelmingly the chief factor in the farm improvement; and the deficiencies of the policy as a permanent program have been pointed out as frankly and forcefully by Secretary Wallace (see his annual report), and by other sincere believers in the necessity for overhead control of agriculture, as by anyone else.

The A.A.A. in Cotton

Undoubtedly the A.A.A. has operated more effectively in cotton than in any other commodity, and a return to unrestricted production would therefore be expected to have its greatest effect on cotton. In 1933, its first year, the A.A.A. subsidized the plowing up of 10,500,000 acres of growing cotton which would have produced 4,000,000 bales. In 1934 and 1935 it held the planted acreage down to 28,000,000 and 29,000,000, respectively, compared with 41,000,000 the 1929-33 average, and 44,500,000, the base acreage on which the A.A.A. quotas were figured. The crops in those years were only 9,636,000 and 10,734,000 bales.

As a result of these measures, the cotton surplus (July 31 carryover) has been reduced from 13,250,000 bales at the peak in 1932 to 9,000,000 last year, and there will be a further reduction during the current season, probably to below 8,000,000. Along with the crop curtailment, price pegging operations were employed, through the 10 and 12 cent loans, and this season the guaranty of 12 cents to the grower was given. Thus the farmers' gross income from cotton and seed has been raised

from $464,000,000 in 1932 to an estimated $877,000,000 in 1935, including benefit payments.

This reduction in the surplus and increase in farm income represents the credit side of the cotton operations. But at what cost has the improvement been achieved? The direct cost is represented by the $400,000,000 of benefit payments, by the guaranteed price payments, and by the possible loss to the Treasury on the cotton upon which it has made loans. Dr. A. B. Cox of the University of Texas estimates the loss of wages and fees for picking, ginning and handling cotton, due to the restrictions, at $281,000,000. Also what of the cost of maintaining on relief the share-croppers and others who have had to give up cotton growing, or who have lost their work in gins, compresses, warehouses, on the railroads, or on the docks?

Undoubtedly the greatest of all the costs is an indirect one. It consists of the loss of a foreign market for probably two to three million bales of American cotton, due to the stimulation given to cotton growing in other countries by our program. Foreign cotton crops in the five years prior to the A.A.A. averaged 11,000,000 bales annually; in 1935-36 they are estimated at nearly 15,000,000 bales. Due to this competition the world consumption of American cotton in 1934-35 dropped to 11,200,000 bales, the lowest with one exception in eleven years.

In light of these figures, who can say with assurance that the benefits of the cotton program have exceeded its costs? The plan was to restrict production, but it also restricted consumption, making a greater restriction of production necessary. There is no logical end to this circle, short of holding the cotton crop within domestic needs, which is unthinkable.

It is evident that if the Court decision should result in unrestricted planting of cotton this year or next the competition of the increased supply of foreign cottons would be very severely felt. For the coming season the A.A.A. contracts called for a compulsory acreage reduction of 30 per cent from the base, and a permissable reduction, with benefit payments increased accordingly, of 45 per cent. Naturally part of this land would be put back into cotton, and with good growing conditions the acreage would produce a crop in excess of world needs. The surplus in the end would have to find an outlet in the world markets which have been narrowed as described.

This is a bearish view of the price trend in the event of unrestricted planting. Spot prices and the near months in futures, however, are firm. The Government dominates the spot cotton market through its control of approximately 6,000,000 bales, upon which it has advanced money to producers at prices higher than the markets. Spinners will need part of this cotton this season, which gives the Government the power to "squeeze" the market if it is so inclined, but of course a "squeeze" disrupts trade.

The Wheat and Hog Situation

Milk and dairy products, poultry and eggs, cattle, and fruits and vegetables, all major sources of cash income to the farmer, were but little affected by the A.A.A., and no marked changes due to the decision are apprehended. Wheat and hogs have been subject to production control, but the present policy is to encourage an increased output of both. The wheat contracts this season call for only 5 per cent reduction from the base acreage, and of course the Winter wheat area, the larger part, is already planted. Hence, removal of restrictions could not alter the wheat crop materially. Incidentally, the Winter wheat acreage is the third largest on record.

The immediate wheat situation is a strong one, due to three consecutive short crops, for which drouth was far more responsible than the A.A.A. This season imports of milling wheat are required, and the carry-over at the end of the season will be smaller in quantity and poorer in quality than in eight years. Therefore a larger crop is needed to restore reserves of good wheat, and while a yield above domestic needs is expected, with average weather conditions, the surplus is not likely to be unmanageable. The world situation also is the best since 1928.

The A.A.A. was responsible in the beginning for the reduction in the hog supply, through the slaughter of pigs and sows in 1933, but later the drouth and feed shortage took the situation out of the Administration's hands, producing an acute scarcity of hogs and consequent rise of prices to above $12. Hence the current hog contract allows the production of 100 per cent of the base quota; and where no restrictions exist nullification of the power to restrict would obviously be meaningless for the present.

The cycle of hog supplies has again turned upward. The Fall pig crop in 1935, which will be marketed this Spring, was 31 per cent larger than a year earlier, and the number of sows to farrow in the Spring is estimated to be 24 per cent larger. However, the position is strong. Slaughter supplies this year will be the smallest, except for 1935, in 25 years. Meanwhile the invalidation of the processing tax has improved the price of hogs while lowering the price of pork; undoubtedly the tax has fallen in part on the producers, as well as on the consumer and packer, and now each gets part back. Lower pork and lard prices will stimulate consumption, and probably exports also.

The A.A.A. as a Permanent Program

We lack space for further discussion of the effects of the A.A.A. in various markets, for it is important to consider other aspects of the policy, and in particular its suitability, in principle and in practice, as a long-time agricultural program. Obviously if it is unsound or impracticable its unconstitutionality need cause no regrets, and the country will benefit by getting ahead with a sound program.

The economic question at issue is that of the relative merits of a controlled or a free agriculture. The Act put emphasis, in its title and otherwise, upon "adjustment" and it is certain that under any economic system adjustments become necessary. But it is very much to the point to ask by whom adjustments should be made. In a controlled agriculture they are made by the direction of an overhead authority, calculating requirements, planning production, distributing quotas to individual producers, and otherwise intervening in the natural economic processes as its power or judgment may direct. The adjustments fall of necessity upon all producers, irrespective of differences in their efficiency, equipment, or land.

Under a system of individual effort adjustments are accomplished by individuals seeking to make profits or avert losses. They shift from one crop to another, or from one occupation to another, or they reduce costs to stay in their own business; and since shifting is frequently a painful process the incentive to reduce costs is great. Automatically the system operates to encourage cost reduction, experimentation, and pioneering, which are the sources of all economic progress. It puts the burdens of adjustment upon the highest-cost and least efficient producers, and if progress is to continue that is where the burdens belong.

Tendency to Maintain High Cost Production

One of the unquestioned flaws in the experience with the A.A.A. is that it has had to treat all producers alike. There are differences between the productivity of land and the efficiency of farmers in the same farm area, and also between the various sections of the country. But general crop curtailment could take no account of these differences. All farmers are treated as "average" farmers. Secretary Wallace in his annual report brings out this criticism very pointedly:

> Emergency adjustment contracts, as a matter of convenience, had to be based on the past production of individual farmers. That tended to make past production a sort of property right, to perpetuate maladjustments among farmers and regions, and to prevent desirable adjustments to changing economic, physical, and climatic conditions. Farmers made flat percentage cuts from their historic production base. Such flat-percentage adjustments tended to give the highest base to farmers who had responded slowly to the changed market conditions after 1929 and to penalize farmers who had responded more promptly to the reduced demand. Moreover, the emergency adjustments tended to freeze farm production in the historic mold, in violation of efficient practice.

Since the War there have been great shifts in the distribution of farm production among the States, due to the opening of new lands west of the Mississippi River. The center of cotton production has shifted to Texas and other Western States, and the center of wheat production to Kansas and the Southwest. Such shifts were natural, occurring in response to lower costs of production on the Western plains, but they or any other shifts would be stopped by inflexible quotas. Plainly, any plan which gives allotments alike to efficient growers on low cost land and inefficient growers on high cost land must result in artificially high costs and prices which will restrict consumption.

Secretary Wallace and his staff have been unremitting in their study of this phase of the adjustment program. Each year the programs have sought to provide for more flexibility in allotments, and to realize an objective described by Mr. Wallace as follows:

> Broadly, the object of a long-time farm-adjustment program should be to promote and encourage the best utilization of the individual farmer's resources, and at the same time to adjust farm production as a whole to yield the maximum farm income over a period of years. Essential to the program would be action to conserve soil fertility and to find other than farm uses for land not suited to farming. . . .
>
> In long-time adjustments it seems desirable to develop a regional basis, so as to avoid conflict between adjustment quotas and the principles of good land use, balanced farming, and sound farm management. Otherwise it will be difficult to combine the fair treatment of individual farmers with necessary changes in the localization and production of crops.

This is a lofty goal, but plainly the difficulties are enormous. Mr. Wallace calls attention to the inter-regional conflicts involved. Feed growers want high prices; dairymen and livestock feeders want cheap feed. Will high cost producers willingly accept a greater burden of crop restriction so that low cost producers may bear less? Land surveys have been sponsored to recommend changes considered desirable for soil conservation and good farm practice. Mr. Wallace hopes that with experience programs may be devised which would combine control of production by commodities with control of land use according to principles of good farm management. With all respect, is there any practicability of carrying out a program so indescribably complex and difficult? Agriculture would have to submit to a degree of regimentation far greater than it has hitherto experienced. What would be the attitude of the farmer as such a program developed, leading almost certainly to the condition described by Mr. Wallace not long ago as "Every plowed field would have its permit sticking up on its post"?

Tendency of Control to Spread

Once control of production is begun its tendency is to spread from one area to another,

and this has been the history under the A.A.A. Adjustments in one place have required compensating adjustments in others. Acreage removed from cotton and tobacco was put into peanuts and potatoes. Thus early in the history of the act the process of adding to the list of basic commodities began, and the original list of seven had been expanded to seventeen.

Moreover, reliance upon voluntary cooperation in the adjustment program became less and less satisfactory to those who wished to see the parity prices attained more rapidly. Logically resort was had to compulsory measures of restriction, such as the Bankhead Act in cotton, the Kerr-Smith Tobacco Act, and the Potato Act. This extension of control has not in general had the approval of the Department of Agriculture's experts. Secretary Wallace himself described his task of enforcing the Bankhead Act as "abhorrent", and his views upon the Potato Act are well known. However, the probability that controls, in practice, may be used unwisely, has to be considered by those who sincerely believe in the principle. These additions to the A.A.A. policy were made by processes of democratic government. If control of agriculture is to work, it must work in the sort of society and under the kind of government under which we live. There was never assurance that plans devised even by infinitely wise and impartial counsellors could be kept free from political interference.

Undoubtedly the record includes examples of the fallibility of the planners also, as well as interference with their plans. The effects of the cotton program in reducing consumption were under-estimated; the pig slaughter proved a mistaken policy in view of subsequent developments; the wheat acreage reduction programs never achieved their goal, and the curtailment was greatest where production costs are lowest, and least where wheat costs most to grow. In general reserve supplies of grains and feed were allowed to run too low, so that imports of foods and feed from many lands became necessary. All this is evidence of the difficulties which planned adjustments encounter.

The Principle of Parity

If the practice were perfect the A.A.A. could benefit the country as a long-term program only if it were correct in principle as well. The declared purpose of the Act was "to establish and maintain such balance between the production and consumption of agricultural commodities" as would give farmers the so-called "parity prices", to wit, the same ratio between prices of farm products and of goods which farmers buy as existed in the period 1909-1914. Thus the law embodied the principle that farmers are entitled as a body to a guaranteed equality of return.

There is no dispute as to the fact that when the Act was passed farm prices were at a disparity with prices of industrial goods, and this disparity was a chief cause of the disruption of trade. Admitting that emergency action was worth its cost, the concept of parity has been a temporarily useful guide. However, if farm returns are to be guaranteed the guaranty must apply to all those engaged in farming, regardless of how many they may be, and also to those who may be attracted to the land by this promise of parity. Evidently such a guarantee, over any long period, is wholly impracticable. All inquiries into the state of agriculture come to the conclusion that there are too many farmers, but all proposals to establish "parity" are for the purpose of making farming more attractive. If more people wish to engage in farming than are required the guarantee must necessarily be at the expense of other classes of the population, and the economic law permits no favoritism. The returns of the various occupations must be free to fluctuate in order to insure the balanced distribution of the population among the occupations, which is essential to prosperity.

Moreover, it is plainly impossible to define the parity in mathematical terms, or in terms of price relations in any past period or of the desires of the producers in question. The price and income relationships needed to maintain the balance are constantly changing. All technical or natural developments, affecting production costs, affect them. If costs are reduced in farming the farmers can no longer expect, nor do they any longer need, the same prices for their products. Also developments in the various branches of agriculture and in the industries producing competitive products may affect the "fair exchange value" of any farm product, since fewer people will be required to produce it, and the high cost producers can be turned to something else. If any group of the population insists upon a fixed return and upon restriction of production to obtain it the result is scarcity, and if all groups insist the scarcity is general.

Secretary Wallace in his annual report subjects the principle of parity prices to a searching examination. "There is more," he says, "to good rural-urban balance than simply parity prices":

> **Parity prices established on a very high level through excessive reductions in the farm output would not last. Such prices could be attained but not maintained. Parity prices must harmonize with increasing consumption if they are to endure. * * * Beyond a certain point price gains at the expense of sales involve a loss of income. Parity prices will not return parity incomes if the volume of production decreases excessively. In the long run the farm income depends on the buying power of consumers.**
>
> **The full year 1935 will furnish a convincing demonstration that the best production policy for agriculture is adequate production for the available market. Crop reduction has reached the point of diminishing**

returns. * * * Fundamentally, the problem is to give agriculture its due share of the national income through an approach to abundance rather than through an approach to scarcity.

These extracts constitute a plain statement of the dangers in a literal acceptance of the parity principle.

The Soil Improvement Proposals

It is true of all attempts to impose overhead control upon economic relationships that they can succeed and prove beneficial only to the extent that the control policies are in accord with the economic law and facilitate its operation. The proposals for Government aid in retiring eroded, worn-out and other submarginal lands, for purposes of reforestation and soil improvement, have the advantage of harmonizing with the natural law, which in the end makes production on these lands unprofitable and therefore commands their retirement. Also the conservation of soil resources, under circumstances where individuals may not be expected to act, is properly a concern of Government. A sound and practicable program for this purpose would fit the requirement above given, i. e., it would facilitate the operation of the economic law; and there are good arguments for such a program. The farm situation would be benefited by the elimination of high-cost and, for the present, unneeded production. To be sure, the benefits should be considered in relation to the costs, which would include not only expenditures for the purchase or rental of land, but the cost of maintaining people who have been getting their living from the soil, to the extent that other occupations could not at once absorb them.

Evidently, however, such a program should be confined to land that is in fact submarginal, the decision being made by the competitive markets as well as by the judgment of the overhead authority. If production control should be emphasized also, resulting in the retirement of good land as well as poor, and permitting for example the growth of corn on inferior soil in Georgia while better land in Iowa was held idle, then the program would be subject to the same economic objections that have been offered against the A.A.A. The Constitutional objection also would be operative, in view of the emphatic language of the decision holding that the power to control agriculture is not conferred on the Federal Government, hence is expressly reserved to the States.

In all the discussion there is danger that too little credit will be given to the ability of American farmers to look out for themselves, to their advantages in soil, equipment and transportation, and to the assistance they obtain from the Federal and State Departments of Agriculture, which have had long and honored records in improving farm practices, supplying information which farmers cannot get for themselves, and fighting their enemies of insects and disease.

In last analysis the surplus problem is a problem of inability or unwillingness to compete in the export markets. Even the cotton program has been based on the assumption that the living standards of cotton growers would be intolerable if they sought to hold their accustomed place in the world cotton markets. But this country is admitted to have the greatest natural advantages for cotton growing and the best equipment for cotton marketing in the world, and evidently the living standards of the growers should be the highest in the world. Plainly the way to better living standards is to utilize their advantages, increase the efficiency of their operations, and grow more cotton on fewer acres, at lower costs. Of course prices of things cotton growers buy enter into their costs. This opens up a new field for comment and we have no space to enter it, except to say that if these prices are out of line the attack upon them should be direct, instead of attempting to balance them by the willful creation of a scarcity.

Wealth and Its Distribution

This series of articles upon the Economic System has dwelt with emphasis upon the principle of specialization and exchange, in explanation not only of the increasing complexity and efficiency of the system, but of the alleged "instability" that is the principal charge against it. It is not denied that the system is unstable in the sense that it is constantly undergoing change, for change is a condition of progress. Because the various industrial groups are virtually exchanging services, it follows that important changes in their relations may cause disorder. They may increase employment in some places and cause unemployment in other places, but if the changes are to better ways of doing things, creating new products, new industries, increasing the supply of wealth in distribution, making labor more productive and increasing its compensation, the results are not harmful, but beneficial. The record of the economic system shows that improvements in industrial methods have enormously increased both the volume of products and the compensation of labor.

Changes in the relations between the parts of the system result from changes in production, consumption or prices, but usually prices are governed by production. Furthermore, changes in relations may originate either within or outside of the economic system, but regardless of origin such changes affect the flow of the exchanges and disturb business, prices and employment. The various groups of the system must be kept in balance in order to have prosperity. A changing system—a

progressive system—must be flexible, adjustable, to maintain its equilibrium, and the members must adapt themselves to the conditions that are the price of the gains they seek. The members must be the stabilizing factor: employment must be sought in the industries that can give it, and price relations must be such as will enable the various groups to buy each other's products with the proceeds of their own. These conditions do not originate with employers or capitalists, but are inherent in the system of specialized production and exchange.

It is important to say that changes normally made in industry for the improvement of its methods do not cause widespread unemployment; they take effect gradually, and natural changes in the working forces enable them to be made without serious disturbance. If any ill effects occur, they are incidental, limited, and counterbalanced by general and lasting benefits. The history of the principal industries verifies this statement. It is the violent and abnormal disturbances, originating outside of the economic system and affecting all business, that cause the general and prolonged depressions. War has been the chief of these causes.

Agriculture and coal-mining are among the industries that have suffered most in this depression and in both cases attempts have been made to provide relief by legislation. The Supreme Court has held parts of this legislation to be in conflict with the fundamental law and therefore invalid. The decisions excite much comment. Why is it that the Constitution adopted by the founders of this Government does not permit such legislation? Has the country outgrown the Constitution? Would the legislation have been beneficial or harmful? These questions are considered in this discussion.

Agriculture, the Mother Industry

Agriculture, including live stock-raising, was the first industry, and has been the mother industry, not only by providing immediate necessities, but by being a continuing source of labor-supply for all the other industries. In early times the population was spread over the land, and almost wholly occupied in getting a bare living. As increasing population pressed for food, clothing and shelter, it was only by improvements in methods of production that any labor could be spared for other purposes. In all countries the increasing productivity of agriculture has been accompanied by a movement of population from the land to the cities and the other industries and occupations. In the United States the farm population has fallen off relatively, in the last 100 years from about 75 per cent of the total population to 25 per cent, and even so, the increasing volume of farm products has been disproportionate to the growth of population, causing by its effect on farm incomes a continuing migration, mostly of young persons, from the farms to urban employments. This movement has been significant of economic pressure, and the pressure would have been greater but for the movement.

About 1900 this situation changed somewhat, owing to the cessation in the 'nineties of the subsidized railroad-building that had been going on in new countries for forty years, and that by its excessive stimulus to land settlement had caused the world-wide depression of the 'nineties. The world turned a corner into a relative scarcity of foodstuffs, with better rewards to farming, higher land values resulting, but with higher living costs in cities. The latter tendencies were accentuated by the Great War, raising all prices and wages, and prompting a great increase of crop acreage in countries outside of Europe; but after the War the increased production exceeded demands, prices fell disastrously, and importing nations have reduced their takings from this country.

Diminished Use of Work Animals

A new influence making for a diminished consumption of farm products has been the substitution of motor-power for animal power, not only for urban uses but on the farms. The Bureau of Agricultural Economics has collected data on this subject, part of which is given below. Horses on farms declined from 20,092,000 in 1920 to 11,827,000 in 1935, horses and mules from 25,748,000 to 16,622,000. From 1910 to 1930 the average investment in farm implements and machines per crop acre increased from $4.06 to $9.14 and the average investment in animal power declined from $8.39 to $3.74. Additional data follows:

The automobile, truck, tractor, and improved farm machinery replaced about 10,000,000 horses and mules between 1910 and 1930, including city horses and mules.

This replacement by machinery made available for other uses the land previously required to produce horse feed and this acreage was used for growing other crops.

The total acreage so released can not be exactly measured, but the upper and lower limits are reasonably well defined as:

- **For 1910 to 1930, 30,000,000 to 45,000,000 (released by all horses and mules).**
- **For 1920 to 1930, 26,000,000 to 35,000,000 (released by all horses and mules).**
- **For 1920 to 1930, 18,000,000 to 24,000,000 (released by farm horses and mules).**

A considerable percentage of plowable pasture has also been released but it is not closely measurable.

The acreage released from crops previously required for horse feed has resulted in increases of nearly all other crops.

All of the changes mentioned above show the importance of the *equilibrium* in economic relations. In the ten years from 1899 to 1909 the population of this country increased 21 per cent and area in farms increased only 15 per cent, and much of the 15 per cent was of very uncertain yields. The earlier migration

from the farms slackened with the rising prices of farm products, as the population gained on acreage.

The outbreak of the war and the interruption of shipments from eastern Europe abnormally stimulated production outside of Europe. After the war, Europe's production increased and the governments restricted importations to protect their home producers, and are now taking less of our farm products than at any time in nearly 100 years. This has been a highly important factor in disturbing our equilibrium. The changes resulting from the war were violently disturbing to prices and in their influence upon the exporting countries. The high prices of the war-time stimulated both an increase of farm acreage and the development of farm mechanization. The latter results not only in a substitution of motor-power for horse-power, but in the use of implements of increased capacity, as seen in the table published in these columns last month, thus increasing the capacity of the farm worker in two ways.

The changes in diet are another factor of importance. The increasing preponderance of indoor occupations, with less muscular effort, lessens food consumption. We use less food for energy and more of engine power. We do not walk as much as formerly. Furthermore, the changes in transportation facilities have resulted in a greater variety of food, with a decline of the old standbys. The cereals have suffered most, falling from about 350 lbs. per head in 1899 to 220. On the other hand, vegetables (now fresh all the year round), fruits (largely canned), sugar, also fats and oils, have increased (the last three mainly by importations from tropical countries). These changes are due to consumer choice, and are no more alterable than the other factors mentioned.

The Fundamental Farm Problem

The disequilibrium, caused by natural developments (plus the war disturbances) has been, and is, the farm problem, and the surplus that has been making it has been the surplus of farm population in proportion to the total population. Nor can it be assumed that the farm population will be fixed and static in the future; it is naturally increasing, and there is practical certainty that its capacity to increase the per capita supply of food products will be maintained. The demand for food products does not increase per capita, and cannot keep pace with the aggregate demand for all other products and services. The latter have a variety and appeal that assures practically unlimited demands, subject to the one condition, that balanced relations shall be maintained, so that they will buy and pay for each other in the markets. The natural remedy for excessive production in agriculture is by a transfer of workers to the new and growing industries, as in the past. There is no gain from labor-saving unless the labor is used for other purposes.

Most of the arguments for farm relief legislation have been based upon the assumption that the relations between agriculture and the other industries are static, unless arbitrarily changed by law or organized effort; that the farm population is static and entitled to a certain parity of compensation, regardless of the fundamental factors that govern all relations within the economic system. These assumptions are erroneous.

Dr. Mordecai Ezekiel, economist on the staff of the Secretary of Agriculture, in an address before the Virginia Institute in July, 1934, described the agricultural situation practically as stated above. We quote a few sentences from it:

If each of you in this audience were to list the things you would buy if you had an extra thousand dollars income to spend in the next year, you would find that almost all the items on the list were the products of factories rather than of farms. Higher standards of living always include much more of industrial products and only slightly more farm products than do lower standards.

* * *

With growing efficiency in agriculture, therefore, there must be a continuing reduction in the proportion of farm workers, and a continuous shift of population from farming to other lines of work.

* * *

Even now we could produce all the farm products we need with 60 per cent of our present farmers. As soon as industrial activity is restored and the urban unemployed are again employed at useful work, we should turn to the task of helping these four million workers, unneeded in agriculture, find more productive occupations elsewhere.

Professor Tugwell has given a forecast that in view of the declining rate of population growth, and the increasing productivity of agriculture per acre, probably no increase of farm acreage will be needed in the future, and presumably this prediction applies also to farm population.

These facts as vouched for are something to think about. The natural growth of population is faster in rural communities than in the cities, which in the light of these comments would seem to mean that the movement to the cities will have to equal all of the rural gains, in order to maintain the equilibrium. In view of past relations between agriculture and the urban industries, would it be advantageous to agriculture to gain an increasing proportion of the total population, either with a corresponding increase of its own production or with an artificial restriction of it?

Is it possible to determine the actual "parity" between city life and country life by the exercise of authority? The parity is different for different persons, and some of the proposed parities might start a movement from city to country. And, finally, *not force or authority, but balance*, governs in economic relations.

Experience affords warrant for believing that there is no remedy for a continuing surplus

of farm products or anything else, but by increased demand or diminished production; that purchases by the Government do not dispose of the product; that dumping abroad provokes hostile legislation; and that neither of these, nor promotion of certain food products at the expense of others, can be a lasting remedy. Furthermore, while "subsistence homesteads" might alleviate unemployment, they would aggravate the farm problem by making low-paid producers of people who should be employed elsewhere, at better pay. The very term "subsistence farming" is repugnant. It can hardly be doubted that with returning prosperity this class of farming will tend to fade out of the picture.

We have seen that the growth and increasing variety of the other occupations have been made possible by the release of labor from agriculture; also, that agriculture has gained by the transfer in various ways; notably, by an ever enlarging market for its products, with less competition, and also by the services of other industries. Refrigeration, canning, dehydration and transportation facilities aid in the distribution of food products; improvements in tools and implements reduce the costs of production, and increasing efficiency in all the industries tends to increase the exchange value of farm products. All of the industries are serving each other, and are benefited by balanced and reciprocal relations. Such relations constitute the only possible "parity".

The Law of Supply and Demand

The law of supply and demand is said to be old-fashioned and in disrepute, but we venture to offer an example, afforded by agriculture, of its services in directing production and improving the efficiency of the economic system. Among the notable contributions to agriculture by science, manufactures and business have been the "milk test," the cream separator and the varied equipment of the dairy industry. With their aid a new dairy industry has been built up, and one feature of it is the "dairy-herd-improvement association," more commonly called "cow-testing association." The Bureau of Dairy Industry, Department of Agriculture, has estimated that one-third of the cows of this country afford no profit to their owners, and that this has long been so. This is a deplorable state of depression in an important branch of agriculture, and these "cow-testing associations" have been organized by dairy farmers to deal with it. A group of farmers, approximately 26, employs an expert to regularly test the milk and butter-fat production of each cow of their herds. This, with a book account of the daily ration, enables a calculation to be made of the profit or loss on each cow. The records of such associations uniformly show that the average yields rise steadily. For example, here are consolidated figures for all such associations in Pennsylvania, at intervals:

Pennsylvania Cow-Testing Associations

	No. of Associations	Average lbs. milk per cow	Average lbs. butter-fat
1910.....	1	5,724	234.5
1920.....	35	6,577	259.2
1930.....	86	8,081	310.0
1934.....	85	8,126	322.6

The increase of production per cow is made at lower cost.

The "Iowa Dairy Extension Service" has recently announced the results of a comparison of the 52 high and 52 low-producing herds of such associations in that State. In the high herds, the average yield was 11,471 lbs. of milk and 438 lbs. of butter-fat, per cow, while in the low herds the average was 5,659 lbs. of milk and 228 lbs. of butter-fat. In the year ended September 1, 1935, each increase of 100 lbs. in production cost $6.00, and the income over feed-cost increased $17.00. For the high-producing herds net income over total feed-cost averaged $86.40 per cow, while for the low-producing herds this average was $28.43. The Council also makes the statement that during 25 years of cow-testing associations' work the average production of cows has increased 57 per cent, while the average production of all Iowa cows is estimated to have increased only 25 per cent. The average production of butter-fat by all Iowa cows is estimated at 175 lbs. Average of regularly-tested herds, 325 lbs. Another significant statement is that last year 18 per cent, or one-sixth, of the total number of cows in the association herds were "culled," i.e., eliminated. "Boarders" were sifted out.

The Bureau of Dairy Industry, Washington, D. C., has reported the average production of all regularly-tested herds of this country in 1934 as approximately twice the average of all cows. More cow-testing is done in Denmark than anywhere else. The Danes gave the great idea to us, but it embodies a principle that is not new to us, viz: the principle of *individualism!* It has demonstrated that the total quantity of dairy products now consumed in this country may be eventually supplied by only one-half the present number of cows. What a discovery is this, with all its implications!

This showing of increasing productivity in the dairy industry (both within and without the associations) illustrates the general advance in agriculture that has resulted in the continuing movement of workers from the farms to the expanding urban employments. It also illustrates the social value of individual initiative and leadership, for these dairy associations are setting examples for all dairy farmers. Moreover, this movement of population from country to city has illustrated the tendency of natural forces to maintain the equilibrium, and

the fact that the movement usually has consisted of young people shows the importance of leaving such adjustments to the initiative and choice of individuals.

The Unity of Economic Society

And, finally, the greatest of all lessons from this long-continued migration from the farms to the more diversified occupations is that of the essential unity of interests among all branches of the economic system. The migration has been advantageous to society. Although it appears to some good people, that this increasing efficiency in production is cruel to farmers who do not keep up with it, and must be disastrous to all farmers ultimately. This is all a mistake. This view overlooks, first, that no loss need result from stopping wastes, and furthermore, that like economies are going on in all of the industries, and that this increasing productivity results in a constantly increasing variety and abundance of all the products and services that are offered in the markets, and a constantly rising standard of living for all the people—the ideal purpose of the system. Thus the end-result need not be strife and mutual injuries, but a great and beneficent system of cooperation. It might be called "Socialism" if that name had not been taken for something very different. It is a real Socialism based on individual initiative and responsibility, with each one doing his job as well as he knows how, and rewarded for his deserts. It results in a much larger and broader distribution of "wealth" than any make-believe "socialism" can give. The gains in milk production are no different in kind from gains in kilowatt hrs. of electric current, or ton-miles of freight carried per ton of coal consumed, or in longer railroad trains, coal-mining machines, automatic stokers, all machines over hand tools, or in engine-power over horsepower. This is the meaning of "specialization and exchange," and the only problem about it is that of maintaining the balanced relations throughout the system required for an uninterrupted flow of the exchanges. "Hoard's Dairyman", a well-known authority, speaking for the dairy industry recently has said:

> **Men milk cows because this work promises a return with which goods may be purchased and standards of living raised. Men milk cows because they are interested in automobiles, radios, washing machines, manure spreaders, paints, fences, newspapers, clothes, etc.**

Evidently the exchange relations between dairy products and the other things mentioned are highly important, and they illustrate all of the exchanges—all business.

The farmers in these dairy associations do not all have equal results: many factors account for the gains, for example: choice of cows, breeding and rearing of cows, the "balanced ration," and all that is included in "care and treatment." The first to introduce improved methods gain advantages by them, but after all have adopted them the gains go to consumers. Those who excel do so by methods open to all, and their achievements are beneficial to the community as well as to themselves. The principle of *individualism* is even more important in the dairymen than in the cows.

Two aims must be kept in view: (1) efficiency in each branch of the economic system, (2) reciprocal trade relations between the branches; the first is illustrated by the dairy associations, the second by the relations between the dairy industry and other industries. Progress and prosperity are thus linked together.

Dealing With Depressed Industries

With one-third of the dairy cows yielding no profit, there are two ways of dealing with the situation: One is by having a sufficient number of the high-cost producers voluntarily shift into some other employment, thus restoring balanced relations between supply and demand; they are doing no good for themselves where they are and might do better elsewhere. The alternative is to establish an authority to limit and allot production and raise the price. This would protect the high-cost production from competition, restrict and discourage the low-cost expansion, while the higher price to consumers would lower their purchasing power and compel them to economize, either in quantity of milk or elsewhere. This would proceed until a new equilibrium was established, with the costs and wastes of the new system distributed all along the line. That anybody would gain is more than doubtful; certainly the wastes would far exceed the gains.

The Remedy for Unbalanced Relations

It is often said that society owes everyone a chance to earn a living, i. e., a job, and this may be readily admitted, subject to qualifications. It would not be true that society owes everyone a living on his own terms, either as to the kind of employment, the place, or the compensation, for any such guaranty to everybody plainly would be impracticable. Economic society must keep solvent, or all its guaranties will be worthless. It functions by an exchange of services, which means that all relations are subject to mutual bargaining and to the changing conditions of production and trade. The relations should be adjustable, orderly, cooperative, with the whole body permeated by a sense of mutual interests. The free play of natural forces tends to distribute individuals into the occupations where they can be most useful to the whole and to themselves, as shown by the long-continued movement from country to city. Under these conditions the law of supply and demand will afford all of the guidance necessary to main-

tain the equilibrium, the highest practicable efficiency and the lowest living costs, with the minimum of unemployment.

There may be excessive production of anything in proportion to the other things that people want, but we are so far from an overproduction of all things wanted that there is no need to think about that. There is no limit to the employment that may be had by exchanging services, on mutually beneficial terms.

All of the disorders and abuses of the economic system result from unbalanced relations. If the industries cannot trade their products they cannot give employment. If wants and supplies would match up readily, there would be no surpluses, with their disturbing influence upon prices and wages. Under a regime of individual freedom, the matching must be done by the people themselves.

The Coal Industry

We referred last month to the troubles of the coal industry. It also presents the problem of the equilibrium. Like agriculture, it was stimulated and expanded by war time demands, and has suffered by increasing competition and a declining demand. We shall not discuss the Guffey act further than to say that if the purpose is to regulate production, prices, wages and hours of labor in the coal industry, making conditions more comfortable for all factors in that industry by increasing the price of coal to consumers, it is evident that if it accomplished the purpose other industries would demand similar provisions for themselves. See the Ellenbogan bill, now pending to regulate the textile industries, as an example. Such measures would lead to a concentration of authority in numerous public Boards for the regulation of practically all industry and employment.

It is not difficult to foresee that this would not solve the real problem, which is the right distribution of the workers among the employments, and the maintenance of truly reciprocal relations between the groups. The cost of living for every group would be affected as much by what was done for the other groups as by what was done for itself, and such factors as efficiency and balanced relations would be likely to receive even less attention than now.

The prospect would be for an interminable struggle between the industries, and also within them, over their relations and for control of the Boards. Instead of the simple process of readjustment under the impartial direction of consumers' wants, there would be a prospect of both industrial and political strife. Instead of tending to unify all parts of the economic system in one harmonious organization, by a common emphasis upon service to consumers, this policy would emphasize the imaginary rivalries between the parts, and aggravate the mistaken antagonisms. The efficiency of the system is dependent upon cooperation between the parts.

The arguments for government boards to control the industries are the same that are offered for the 30-hour week, with its cycle of rising hourly wages, falling employment, and higher living costs, ending nowhere but in scarcity and privation. Progress would be stifled. We repeat the question: Would the wage-workers rather have more idle time on their hands or more of the products of the industries? The choice is up to them.

The Constitutional Question

Our readers are aware that in making these comments we do not ignore or estimate lightly the state of disorder resulting from the War and credit inflation. We have not been indifferent to distress in agriculture and coal-mining or failed to appreciate the difficulties confronting those industries. The decision of the Supreme Court in the agricultural case does not deny to Congress the authority to give aid where necessary, but rather strengthens that authority under the "general welfare" clause. It only denies the authority to use such aid as a means of establishing in Washington a system of central control that might be extended without limitation. The founders of this Government did not believe that such authority should be given to any government. They were believers in *Individualism,* in the doctrine that the exercise of individual liberty was necessary to its preservation, and to social progress. They valued individual independence and responsibility as a fundamental condition of citizenship in this Republic—a privilege and an obligation as well as a right—and the Supreme Court has held that any extension of the authority of government that would lessen the implied obligation, whether such extension be obtained by compulsion or by "inducements" offered by the government from the public Treasury, is a violation of the spirit and intent of the Constitution. It would make a different order of society, for men who yield to "inducements" are not doing their own thinking; they are not free men. Clearly this is the significance of the decision.

The discussion can go no further in this number.

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